

§ 1.860A-1

- (iv) Deferral of interest.
- (v) Prepayment interest shortfalls.
- (vi) Remote and incidental contingencies.
- (4) Form of regular interest.
- (5) Interest disproportionate to principal.
 - (i) In general.
 - (ii) Exception.
- (6) Regular interest treated as a debt instrument for all Federal income tax purposes.
 - (c) Residual interest.
 - (d) Issue price of regular and residual interests.
 - (1) In general.
 - (2) The public.

Section 1.860G-2 Other rules.

- (a) Obligations principally secured by an interest in real property.
 - (1) Tests for determining whether an obligation is principally secured.
 - (i) The 80-percent test.
 - (ii) Alternative test.
 - (2) Treatment of liens.
 - (3) Safe harbor.
 - (i) Reasonable belief that an obligation is principally secured.
 - (ii) Basis for reasonable belief.
 - (iii) Later discovery that an obligation is not principally secured.
 - (4) Interests in real property; real property.
 - (5) Obligations secured by an interest in real property.
 - (6) Obligations secured by other obligations; residual interests.
 - (7) Certain instruments that call for contingent payments are obligations.
 - (8) Defeasance.
 - (9) Stripped bonds and coupons.
- (b) Assumptions and modifications.
 - (1) Significant modifications are treated as exchanges of obligations.
 - (2) Significant modification defined.
 - (3) Exceptions.
 - (4) Modifications that are not significant modifications.
 - (5) Assumption defined.
 - (6) Pass-thru certificates.
- (c) Treatment of certain credit enhancement contracts.
 - (1) In general.
 - (2) Credit enhancement contracts.
 - (3) Arrangements to make certain advances.
 - (i) Advances of delinquent principal and interest.
 - (ii) Advances of taxes, insurance payments, and expenses.
 - (iii) Advances to ease REMIC administration.
 - (4) Deferred payment under a guarantee arrangement.
 - (d) Treatment of certain purchase agreements with respect to convertible mortgages.
 - (1) In general.

26 CFR Ch. I (4-1-04 Edition)

- (2) Treatment of amounts received under purchase agreements.
- (3) Purchase agreement.
- (4) Default by the person obligated to purchase a convertible mortgage.
- (5) Convertible mortgage.
- (e) Prepayment interest shortfalls.
- (f) Defective obligations.
 - (1) Defective obligation defined.
 - (2) Effect of discovery of defect.
 - (g) Permitted investments.
 - (1) Cash flow investment.
 - (i) In general.
 - (ii) Payments received on qualified mortgages.
 - (iii) Temporary period.
- (2) Qualified reserve funds.
- (3) Qualified reserve asset.
 - (i) In general.
 - (ii) Reasonably required reserve.
 - (A) In general.
 - (B) Presumption that a reserve is reasonably required.
 - (C) Presumption may be rebutted.
 - (h) Outside reserve funds.
 - (i) Contractual rights coupled with regular interests in tiered arrangements.
 - (1) In general.
 - (2) Example.
 - (j) Clean-up call.
 - (1) In general.
 - (2) Interest rate changes.
 - (3) Safe harbor.
 - (k) Startup day.

Section 1.860G-3 Treatment of foreign persons.

- (a) Transfer of a residual interest with tax avoidance potential.
 - (1) In general.
 - (2) Tax avoidance potential.
 - (i) Defined.
 - (ii) Safe harbor.
 - (3) Effectively connected income.
 - (4) Transfer by a foreign holder.
 - (b) [Reserved]

[T.D. 8458, 57 FR 61299, Dec. 24, 1992; 58 FR 15089, Mar. 19, 1993, as amended by T.D. 8614, 60 FR 42787, Aug. 17, 1995; T.D. 9004, 67 FR 47453, July 19, 2002]

§ 1.860A-1 Effective dates and transition rules.

- (a) *In general.* Except as otherwise provided in paragraph (b) of this section, the regulations under sections 860A through 860G are effective only for a qualified entity (as defined in § 1.860D-1(c)(3)) whose startup day (as defined in section 860G(a)(9) and § 1.860G-2(k)) is on or after November 12, 1991.
- (b) *Exceptions—*(1) *Reporting regulations.* (i) Sections 1.860D-1(c) (1) and (3),

Internal Revenue Service, Treasury

§ 1.860A-1

and § 1.860D-1(d) (1) through (3) are effective after December 31, 1986.

(ii) Sections 1.860F-4 (a) through (e) are effective after December 31, 1986 and are applicable after that date except as follows:

(A) Section 1.860F-4(c)(1) is effective for REMICs with a startup day on or after November 10, 1988.

(B) Sections 1.860F-4(e)(1)(ii) (A) and (B) are effective for calendar quarters and calendar years beginning after December 31, 1988.

(C) Section 1.860F-4(e)(1)(ii)(C) is effective for calendar quarters and calendar years beginning after December 31, 1986 and ending before January 1, 1988.

(D) Section 1.860F-4(e)(1)(ii)(D) is effective for calendar quarters and calendar years beginning after December 31, 1987 and ending before January 1, 1990.

(2) *Tax avoidance rules*—(i) *Transfers of certain residual interests*. Section 1.860E-1(c) (concerning transfers of noneconomic residual interests) and § 1.860G-3(a)(4) (concerning transfers by a foreign holder to a United States person) are effective for transfers of residual interests on or after September 27, 1991.

(ii) *Transfers to foreign holders*. Generally, § 1.860G-3(a) (concerning transfers of residual interests to foreign holders) is effective for transfers of residual interests after April 20, 1992. However, § 1.860G-3(a) does not apply to a transfer of a residual interest in a REMIC by the REMIC's sponsor (or by another transferor contemporaneously with formation of the REMIC) on or before June 30, 1992, if—

(A) The terms of the regular interests and the prices at which regular interests were offered had been fixed on or before April 20, 1992;

(B) On or before June 30, 1992, a substantial portion of the regular interests in the REMIC were transferred, with the terms and at the prices that were fixed on or before April 20, 1992, to investors who were unrelated to the REMIC's sponsor at the time of the transfer; and

(C) At the time of the transfer of the residual interest, the expected future distributions on the residual interest were equal to at least 30 percent of the

anticipated excess inclusions (as defined in § 1.860E-2(a)(3)), and the transferor reasonably expected that the transferee would receive sufficient distributions from the REMIC at or after the time at which the excess inclusions accrue in an amount sufficient to satisfy the taxes on the excess inclusions.

(iii) *Residual interests that lack significant value*. The significant value requirement in § 1.860E-1(a) (1) and (3) (concerning excess inclusions accruing to organizations to which section 593 applies) generally is effective for residual interests acquired on or after September 27, 1991. The significant value requirement in § 1.860E-1(a) (1) and (3) does not apply, however, to residual interests acquired by an organization to which section 593 applies as a sponsor at formation of a REMIC in a transaction described in § 1.860F-2(a)(1) if more than 50 percent of the interests in the REMIC (determined by reference to issue price) were sold to unrelated investors before November 12, 1991. The exception from the significant value requirement provided by the preceding sentence applies only so long as the sponsor owns the residual interests.

(3) *Excise taxes*. Section 1.860E-2(a)(1) is effective for transfers of residual interests to disqualified organizations after March 31, 1988. Section 1.860E-2(b)(1) is effective for excess inclusions accruing to pass-thru entities after March 31, 1988.

(4) *Rate based on current interest rate*—

(i) *In general*. Section 1.860G-1(a)(3)(i) applies to obligations (other than transition obligations described in paragraph (b)(4)(iii) of this section) intended to qualify as regular interests that are issued on or after April 4, 1994.

(ii) *Rate based on index*. Section 1.860G-1(a)(3)(i) (as contained in 26 CFR part 1 revised as of April 1, 1994) applies to obligations intended to qualify as regular interests that—

(A) Are issued by a qualified entity (as defined in § 1.860D-1(c)(3)) whose startup date (as defined in section 860G(a)(9) and § 1.860G-2(k)) is on or after November 12, 1991; and

(B) Are either—

(1) Issued before April 4, 1994; or

(2) Transition obligations described in paragraph (b)(4)(iii) of this section.

§ 1.860C-1

(iii) *Transition obligations.* Obligations are described in this paragraph (b)(4)(iii) if—

(A) The terms of the obligations and the prices at which the obligations are offered are fixed before April 4, 1994; and

(B) On or before June 1, 1994, a substantial portion of the obligations are transferred, with the terms and at the prices that are fixed before April 4, 1994, to investors who are unrelated to the REMIC's sponsor at the time of the transfer.

[T.D. 8458, 57 FR 61300, Dec. 24, 1992; 58 FR 8098, Feb. 11, 1993; 58 FR 15089, Mar. 19, 1993; T.D. 8614, 60 FR 42787, Aug. 17, 1995]

§ 1.860C-1 Taxation of holders of residual interests.

(a) *Pass-thru of income or loss.* Any holder of a residual interest in a REMIC must take into account the holder's daily portion of the taxable income or net loss of the REMIC for each day during the taxable year on which the holder owned the residual interest.

(b) *Adjustments to basis of residual interests—*(1) *Increase in basis.* A holder's basis in a residual interest is increased by—

(i) The daily portions of taxable income taken into account by that holder under section 860C(a) with respect to that interest; and

(ii) The amount of any contribution described in section 860G(d)(2) made by that holder.

(2) *Decrease in basis.* A holder's basis in a residual interest is reduced (but not below zero) by—

(i) First, the amount of any cash or the fair market value of any property distributed to that holder with respect to that interest; and

(ii) Second, the daily portions of net loss of the REMIC taken into account under section 860C(a) by that holder with respect to that interest.

(3) *Adjustments made before disposition.* If any person disposes of a residual interest, the adjustments to basis prescribed in paragraph (b) (1) and (2) of this section are deemed to occur immediately before the disposition.

(c) *Counting conventions.* For purposes of determining the daily portion of REMIC taxable income or net loss under section 860C(a)(2), any reasonable

26 CFR Ch. I (4-1-04 Edition)

convention may be used. An example of a reasonable convention is "30 days per month/90 days per quarter/360 days per year."

[T.D. 8458, 57 FR 61301, Dec. 24, 1992]

§ 1.860C-2 Determination of REMIC taxable income or net loss.

(a) *Treatment of gain or loss.* For purposes of determining the taxable income or net loss of a REMIC under section 860C(b), any gain or loss from the disposition of any asset, including a qualified mortgage (as defined in section 860G(a)(3)) or a permitted investment (as defined in section 860G(a)(5) and § 1.860G-2(g)), is treated as gain or loss from the sale or exchange of property that is not a capital asset.

(b) *Deductions allowable to a REMIC—*(1) *In general.* Except as otherwise provided in section 860C(b) and in paragraph (b) (2) through (5) of this section, the deductions allowable to a REMIC for purposes of determining its taxable income or net loss are those deductions that would be allowable to an individual, determined by taking into account the same limitations that apply to an individual.

(2) *Deduction allowable under section 163.* A REMIC is allowed a deduction, determined without regard to section 163(d), for any interest expense accrued during the taxable year.

(3) *Deduction allowable under section 166.* For purposes of determining a REMIC's bad debt deduction under section 166, debt owed to the REMIC is not treated as nonbusiness debt under section 166(d).

(4) *Deduction allowable under section 212.* A REMIC is not treated as carrying on a trade or business for purposes of section 162. Ordinary and necessary operating expenses paid or incurred by the REMIC during the taxable year are deductible under section 212, without regard to section 67. Any expenses that are incurred in connection with the formation of the REMIC and that relate to the organization of the REMIC and the issuance of regular and residual interests are not treated as expenses of the REMIC for which a deduction is allowable under section 212. See § 1.860F-2(b)(3)(ii) for treatment of those expenses.